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SUBJECT: POLISH DEFENSE BUDGET UNDER PRESSURE

REF: WARSAW 14

Classified By: Political Counselor F. Daniel Sainz for Reasons 1.4 (b) and (d)

¶1. (C) SUMMARY: Falling government revenues and GDP projections, overdue payments to defense contractors, and uncertainty over the effects of the global economic situation have combined to put Poland's defense budget under considerable pressure. Although defense funding for 2009 represents sizeable increases, a significant portion will have to be dedicated to covering unanticipated 2008 shortfalls. These budget challenges will have a significant impact on GoP defense modernization plans. END SUMMARY.

¶2. (SBU) President Lech Kaczynski signed off January 16 on the 2009 state budget, which allocates approximately USD 8 billion (24.94 billion zlotys, or PLN) for overall defense spending. This corresponds roughly to 1.95% of last year's Gross Domestic Product (GDP) and represents a 10.5% nominal and 7.6% real increase over 2008 figures. Priorities include USD 400 million (1.4 billion PLN) for military professionalization activities and the following foreign deployments:

-- Afghanistan (ISAF):	277.4	mln PLN;
-- Iraq (NATO Training Mission):	4.9	mln PLN;
-- Chad (EU operation):	61.5	mln PLN;
-- Bosnia (EUFOR):	26.26	mln PLN;
-- Kosovo (KFOR):	34.4	mln PLN;
-- Eastern Mediterranean (Active Endeavor):	11.0	mln PLN;
-- UN Peacekeeping (UNIFIL and UNDOF):	58.5	mln PLN.

¶3. (SBU) Defense modernization programs (referred to as "technical modernization") will be funded mainly from the Ministry of Defense (MOD) property expenses sub-account, projected to be 20.8% of overall defense spending or USD 2 billion (5.2 billion PLN). However, spending on modernization programs will not come solely from MOD's budget. For example, implementation of the F-16 program this year will be financed partly from the MOD budget (233.6 million PLN) and partly from the foreign debt sub-account of the overall state budget (280.9 million PLN). Defense Minister Bogdan Klich has identified this year's modernization priorities as air defense, helicopters, Navy modernization, command and control systems, and unmanned aerial vehicles in addition to ongoing programs. Presumably, these current and projected programs will be funded primarily from the property expenses sub-account of the MOD budget.

¶4. (C) In spite of reasonably sound numbers on paper, MOD officials are aware that defense spending will face considerable pressure this year. Poland's Parliament had already trimmed about USD 24.5 million (72 million PLN) before it finalized the 2009 budget in December, while concern about the still unknown effects of the global financial crisis looms over this year's budget as well. MOD

contacts have told us that the General Staff is re-evaluating its acquisition and modernization priorities in anticipation of likely shortfalls in government revenue. The MOD is also reviewing its long-term modernization plan extending to 2018, which is still in draft and will likely not be ready for detailed discussion until the end of February at the earliest. (In remarks last month Klich suggested that projected acquisition and modernization plans over the next ten years would require 165 billion PLN, but the MOD only planned to spend 77.7 billion PLN from its property expenses sub-account during that period, leaving a considerable shortfall to make up from unidentified funding sources.)

15. (C) Adding to the pressures on defense spending, MOD has met with heavy recent media criticism that it had fallen behind on payments to vendors on debts amounting to between USD 600 million (1.8 billion PLN) and USD 1 billion (3.0 billion PLN). While details, and blame, remain unclear, an unexpectedly sharp drop in government revenues at year's end clearly contributed to cash flow problems at MOD and other ministries. MOD officials, including Klich, have acknowledged that the Ministry owes defense contractors 1.8

billion PLN from last year's budget and promised (most recently during a January 22 hearing of the Sejm Defense Committee) that they would repay this amount from the 2009 budget. Our MOD contacts told us they were still assessing the impact of these latest developments, but a likely outcome is to cut back or extend the timelines of projected acquisition and modernization plans. In the meantime, MOD officials told the Defense Committee yesterday that funding for foreign deployments, military salaries and military professionalization would remain the top priorities as the ministry copes with the loss of a sizeable portion of the 2009 budget to repay 2008 obligations.

16. (C) COMMENT: Falling government revenues and GDP projections, unpaid debts to defense companies, and the unknown effects of the global economic situation have created a perfect storm of uncertainty for MOD budget and defense planners. In addition, legal and procedural questions concerning how allocated money must be spent (reftel) complicate MOD planning as well. MOD officials can brief U.S. counterparts about their efforts to cope with these budget challenges at next week's meeting of the Security Cooperation Consultative Group's Finance Working Group. These budget woes will make Polish defense officials more eager than ever to hear detailed data on all possible financing options at the working group session.

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